APPENDIX III

Reprint of Petition for Certiorari in No. 150, October Term, 1952

Western Pacific Railroad Corporation and Alexis I. duP. Bayard, its receiver, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered on October 29, 1951, and also to review that court's order of January 30, 1952 striking from the files their petition for rehearing en banc.

OPINIONS BELOW

[Omitted]

JURISDICTION

[Omitted]

QUESTIONS PRESENTED

1. [Identical with question 1A of present petition.]
2. [Identical with question 4 of present petition.]
3. [En banc question, omitted.]

STATUTES INVOLVED

[Omitted]

STATEMENT

[First 3 pages omitted, being substantially identical with pages 4 to 6 of Statement of present petition.]

BASIC AND INCONTROVERTIBLE FACTS SUMMARIZED.

1. Petitioner sustained a loss of $75 million when its stock in respondent became worthless.

2. It ceased to have any economic interest in respondent on March 15, 1943.

3. Respondent thereafter used petitioner's loss to discharge respondent's tax liability of $17 million.

4. Respondent conceived the plan of using petitioner's loss and carried it into execution by directing the action of petitioner's president, who was also an officer of respondent and in its exclusive pay.

5. Respondent's tax saving resulted from the conjunction of two elements. First, it had to obtain petitioner's joinder in consolidated returns. In addition, it had to use the loss. The loss was petitioner's loss.

Under these facts, petitioner contended that respondent must account for the benefits obtained by it through the use of petitioner's tax credits.

THE DECISIONS OF THE TWO COURTS BELOW.

The District Court held against petitioner on two legal theories. The Court of Appeals swept both of them aside as erroneous in law. The dissenting opinion of Judge Fee states the situation (R. 2239-40):

> "The Trial Court gives two reasons for decision against plaintiff: * * * Neither has any validity.
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> "The major portion of the opinion of the Trial Court is devoted to the proposition that the 'tax escape' was a fraud upon the government, and therefore the proceeds were given to the defendant, an active wrongdoer, * * * The majority of this Court as the opinion shows, does not rely upon it.[5]
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> "A second subsidiary theory was also advanced below with little emphasis. * * * This reason is as unstable as the first."[6]

The majority nevertheless affirmed the judgment, by (a) announcing a new principle of law (discussed at pp. 9-19 below), and (b) applying it to supposed facts not found by the trial court

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[5]The majority opinion states of the District Court's major theory, "We do not share this view" (R. 2227-8, fn. 12).

[6]The subsidiary theory was that petitioner's claim was somehow barred by the reorganization proceedings. The majority opinion makes no reference to it.

and contrary to what the court indicated it would have found had it believed the facts material (discussed at pp. 20-26 below).

STRIKING OF PETITION FOR REHEARING EN BANC.

[En banc discussion omitted]

REASONS FOR GRANTING A WRIT

The court below has decided important questions of federal law which have not been, but should be, settled by this Court, as well as an important question of local law in a way in conflict with applicable local decisions. The questions are of wide public interest, concerning the rights and duties of parties to federal consolidated returns under the Internal Revenue laws and Treasury regulations. The decision of these vital questions is not only erroneous but it is in conflict with decisions of the Second, Fourth and Fifth Circuits. Furthermore, the court below has so departed from the accepted and usual course of judicial proceedings, as to call for an exercise of this Court's power of supervision.

These reasons will be presented under three main heads.

The decision of the Court of Appeals is commented upon in the May, 1952, issue of the Harvard Law Review, where it is suggested that the decision is erroneous (65 Har. Law Rev. 1256-1258).

I.

The Decision Is Based on a Novel Rule of Law, Affecting Taxes, Corporate Reorganization, and the Law of Unjust Enrichment, Without Support of Any Known Principle or Authority.

The basic reasoning of the majority opinion is as follows: If respondent controlled petitioner, it had a fiduciary obligation to deal with it fairly (R. 2223). But it did not violate this duty in filing the consolidated returns or in the failure of the common officers to request and obtain an agreement for compensation for use of petitioner's tax rights, or in respondent's failure to give petitioner an opportunity to appoint independent officers who could have made such an agreement. These acts were not unfair,

said the court, because petitioner was under a duty to file such returns; it could not have demanded an agreement of compensation for doing so, all because petitioner was bound to give to respondent the benefit of its loss (R. 2237-2234).

The opinion sums up: "Equity will not permit a recovery as a substitute for a bargain which would have been unfair," i.e., no bargain for any compensation would have been fair (R. 2235). In short, it was petitioner's duty to give up its sole asset to respondent for nothing.

The majority opinion thus announces a new principle of law, viz.:

That wherever the tax laws permit two corporations to join in consolidated federal tax returns, and one has a loss and the other has income, the former must join with the latter and permit its loss to be used for the latter's benefit, without payment, consideration or compensation.

And since respondent was no longer a subsidiary of petitioner,[7] the principle as applied went further, namely:

A former parent is under a duty to join in a consolidated return and permit its loss to be used to satisfy the former subsidiary's tax, without consideration or compensation, even though it has no economic interest in the latter and can derive no benefit therefrom.

This is tantamount to holding that the income corporation can sue in equity for a mandatory injunction to compel the loss corporation to join and confer the benefit of its loss, gratis.

Fundamentally, petitioner is entitled to recover on the principles of unjust enrichment. Restatement of Restitution, Section 1. The discharge of respondent's tax liability by use of petitioner's loss was an enrichment as much as if respondent had taken dollars from petitioner and used them for this purpose. As stated in 65 Harvard Law Review at 1257, "If, as has been suggested, the Court should not have found that [petitioner] had a duty to file

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[7]As the opinion itself states, "when the returns and the claim for refund were filed, affiliation no longer existed" (R. 2230-1).

consolidated returns, then principles of restitution for unjust enrichment should have governed the decision."

RETENTION BY RESPONDENT OF THE BENEFITS RECEIVED FROM USE OF PETITIONER'S LOSS IN CONSOLIDATED RETURNS IS INCONSISTENT WITH THE RATIONALE OF CONSOLIDATED RETURNS AND THE PURPOSE OF CONGRESS IN ALLOWING THEM.

The principle underlying consolidated returns is this: A group of affiliated corporations is an economic entity and, unless the group as a whole in the conduct of the business enterprise shows a net profit, those who conduct the business—the parent's owners—have realized no gain. *Handy & Harman v. Burnet,* 284 U.S. 136, 140.[8]

The rationale "is the recognition of this common owner's right to set off against his gains in the one [corporation] his losses in the other [corporation]." *Duke Power Co. v. Commissioner of Internal Revenue,* 44 F.2d 543 at 545 (4 Cir.), cer. den. 282 U.S. 903;[9] *Alameda Inv. Co. v. McLaughlin,* 28 F.2d 81 (D.C. N.D. Cal.), aff'd 33 F.2d 120 (9 Cir.).

When the tax law permits one affiliate's profits to be offset against another's losses, its purpose and its effect is to benefit the ultimate owners of the business entity, i.e., the parent's stockholders. The means it adopts is the amelioration of the loss suffered by them because of losses of any one affiliate.

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[8]The legislative reports and similar material are conveniently assembled in II Montgomery's Federal Taxes, Corporations and Partnerships, 1946-47 issue, pp. 632, 633.

Consolidated returns were first required, but only for excess profits tax, by Treasury Regulation in 1917. This was validated by the 1921 Act. Consolidated returns were compulsory for both normal and excess profits taxes between 1918 and 1921, inclusive. They were permissive but not mandatory for 1922-1933, inclusive. They were not permitted, except in case of certain railroad corporations, from 1934-1939, inclusive. They were permissive for all corporations with respect to excess profits taxes in 1940 and 1941. In 1942 the Revenue Act, Section 141(a), extended the privilege to all corporations for all years after December 31, 1941, with respect to both normal taxes and excess profits taxes.

[9]This case contains an excellent statement of the history and purpose of consolidated returns and the concept of the economic unity.

Two principles are evident: (1) The tax saving should go to the ultimate owner of the economic entity, the parent, and (2) it should go to the party suffering the loss, to ameliorate it. So long as the economic unity continues, these two principles coincide. And they coincide here, because the loss used to produce the tax savings was the former parent's loss.

The majority opinion below permits the tax saving to be retained by the former subsidiary, after severance of the economic unity—the very event producing the parent's loss—without making restitution to the parent. Thereby it defeats both equities underlying the principles of consolidated income tax reporting. New owners of the former subsidiary are reaping a sheer windfall from the misfortune of the old owners. The income tax laws are subverted into a tool to enrich strangers to the economic entity for whose protection consolidated returns are permitted.

In *Woolford Realty Co. v. Rose,* 286 U.S. 319, this Court (Cardozo, J.) held that the use of consolidated returns did not permit a corporation to deduct from its profits the loss of an affiliate sustained in a year prior to affiliation. "The mind rebels against the notion that Congress in permitting a consolidated return" was willing to permit a corporation to profit by the loss of one who was a stranger when the loss was sustained.

Here is the converse situation, for the tax savings were claimed after the economic unity was severed. The mind rebels against the notion that, after that severance, respondent may confiscate the tax utility of petitioner's loss. In the words of *Woolford,* "to such an attempt the reaction of an impartial mind is little short of instinctive."

In his dissenting opinion below Judge Fee summarized the matter thus (R. 2248):

> "If we look at it realistically, but little question arises. If the plaintiff were still the owner of the stock of defendant, then the allocation of $17,000,000 to the defendant would be reflected in the increased value of its stock. The transfer of the stock left the right untouched. Since increase in value of stock in defendant no longer is of avail to plaintiff, there

should be another method of applying the remission to the loss."[10]

Senate reports on various revenue bills have justified consolidated tax reporting on the ground that "no ultimate advantage under the tax laws really results,"[11] and that "no improper benefits are obtained from the privilege."[12] On the basis of these passages, *J. D. & A. B. Spreckels Co.*, 41 B.T.A. 370, 375, held that "the framers of the statute [did not intend] that the privilege of making consolidated returns may be enjoyed in cases where the affiliation does not serve a business purpose, as distinguished from a tax-reducing purpose."

But, unless the tax savings here are applied to ameliorate petitioner's loss, an "ultimate advantage under the tax laws" has resulted, "improper benefits are obtained from the privilege," and only a tax reducing purpose has been served: respondent has escaped its taxes because an economic stranger had a huge loss. The District Court was understandably indignant at this result. "If I had the power," it asserted, "I would order these taxes paid to the United States. That would effectively dispose of the cause." (R. 270).

Yet it left the funds with respondent, the unjustly enriched party responsible for what was done. And the majority opinion

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[10]In *Bondholders, Inc. v. Powell*, 342 U.S. 921 (Jan. 28, 1952) and again in *Chemical Bank & Trust Co. v. Group of Institutional Investors*, 343 U.S. ..... (June 10, 1952), Mr. Justice Frankfurter notes that due to erroneous estimates of future earning power, valuable equities were forfeited in a series of railway reorganizations of which the first was *Ecker v. Western Pacific Railroad Corporation*, 318 U.S. 448. Here, although petitioner's stock in respondent was declared worthless in the *Ecker* case, respondent's earned income in 1942-4 was so large that a tax of $21,000,000 would have been paid had it not been discharged by the use of petitioner's loss. The creditors of respondent, not content with wiping out petitioner's equity in respondent and acquiring it for themselves, now contend that respondent, in addition, is entitled to use petitioner's loss, without accountability.

[11]Report of the Senate Finance Committee on the Revenue Bill of 1928, 70th Congress, 1st Session, Senate Report 960, p. 8.

[12]Report of the Senate Finance Committee on the Revenue Bill of 1932, 72nd Congress, 1st Session, Senate Report 665, at p. 9.

below, while disapproving the trial court's reasoning, permits its result to stand.

The consequence is that the revenue laws have been subverted and made absurd.

BY FIAT THE MAJORITY OPINION BELOW MAKES MANDATORY WHAT CONGRESS LEFT OPTIONAL.

The tax laws make clear that (1) only the parent corporation may file consolidated returns; that (2) there was no duty to file such returns; (3) that consolidated returns may be filed only if all affiliates join, and (4) that a parent is under no duty to a subsidiary, nor any affiliate to any other, to file consolidated returns, each being free to make its own decision on the basis of its own interest. Treas. Reg. 104, Sec. 23.11(a), 23.16(a), II Montgomery's Federal Taxes, Corporations and Partnerships, 1946-7, pp. 649-650. *Duke Power Co. v. Comm.*, 44 F.2d 543, 545 (4 Cir.) cer. den. 282 U.S. 903; *George A. Fuller Co. v. Commissioner*, 92 F.2d 72 (2 Cir.); *Trinity Building Corp. of New York*, 40 B.T.A. 1315.

By judicial fiat the court below makes mandatory what Congress and the Treasury left optional. Wherever consolidated returns may be filed with a resulting tax reduction to anyone, this decision decrees that they must be.

The rule so created not only confers on one corporation a right to use another's assets, but it does so free of any requirement of just compensation.

No principle supports such a right. Rather, as Judge Fee stated (R. 2242):

> "plaintiff had a property right to file or refuse to file consolidated returns, which could neither be given away without consideration nor cut off judicially without due process."

As he further stated (R. 2243):

> "Since, under the [tax] law, all corporations concerned must consent to the filing of consolidated returns, it is clear, contrary to the statement in the majority opinion, that plaintiff

had no duty requiring it to file these returns. Plaintiff had a legal right to refuse to file."

65 Harvard Law Review at 1257 comments:

"The ground relied on by the Court of Appeals was that * * * [respondent] could have violated no duty to act fairly since [petitioner] was under a duty to file the consolidated returns anyway. The court's argument that [petitioner] had such a duty, however, is not convincing. The Internal Revenue Code imposes no such obligation."

Moreover, there are many factors besides offset of losses which bear on the question whether it is advantageous to join in consolidated returns (cf. II Montgomery, Federal Taxes on Corporations, 1942-1943, pp. 492, 493-5). Burdens as well as advantages flow from such action. Thus each company joining in the return becomes liable for the full amount of taxes owed by the group (Treas. Reg. 104, Sec. 23.15(a); T.R. 110, Sec. 33.15(a)), and is subjected to requirements affecting its future tax situation. For example, by virtue of elimination of intercompany transactions, the basis at which property is held may be affected (T.R. 104, Sec. 23.38; Tr. 110, Sec. 33.38). In certain circumstances such returns must be filed in a later year (T.R. 104, Sec. 23.11(a); T.R. 110, Sec. 33.11(a)), although "future developments may make the filing of separate returns for future years more advantageous." (II Montgomery, p. 492). Here one consequence of petitioner's joining in the consolidated returns was to make it liable for any taxes payable by respondent. All this demonstrates how indefensible it is to hold that an independent company has any duty to assume such a liability and such possible disadvantages simply to benefit another company which wants to use its loss.

Still again Judge Fee observed (R. 2251):

"An incontrovertible proof of the proposition that plaintiff had no duty to apply the loss for the benefit of defendant may be cited. If plaintiff had sold a gold mine for a profit of over $75,000,000.00, its loss on the stock of the subsidiary could have been applied to offset any taxes against plaintiff.

In that event, the trustees in reorganization would have been required to pay taxes against the operating company. Once used, the power of applying the loss would be functus officii, and plaintiff would have received the entire benefit."

ONE'S RIGHTS OR PROPERTY MAY NOT BE APPROPRIATED MERELY BECAUSE HE CANNOT USE THEM PROFITABLY HIMSELF.

The last quotation from Judge Fee's opinion reveals the fallacy of the majority opinion.

If a prosperous corporation (e.g., Standard Oil Company) had owned respondent's stock, none would claim that it had to join in a consolidated return and give respondent the tax utility of its loss, without accounting for the benefit, for Standard could use the loss to discharge its own taxes.

But because petitioner was so unfortunate as to be left destitute and with no taxable income, the majority opinion applied a different standard. It argues that respondent "did not abuse its supposed dominant position because the officers and directors common to both corporations did not sacrifice Corporation's [petitioner's] interests to those of its subsidiary" (R. 2232). The reason given is that petitioner "had no income" and so "there was no possible way for it to achieve any tax advantage to offset the loss," whereas "its affiliate [respondent] did have use for the loss" (R. 2232). "Under this state of facts these officers had a positive duty to make use of the loss as they did" (R. 2233), that is, to give it to respondent, to satisfy the taxes that otherwise it would have had to pay.

This is merely to assert that a corporation able to dominate another may take its tax credits without compensation if it can profitably use them and the dominated corporation cannot.

Almost anyone can advantageously use another's property or rights—and will, if he can get them for nothing. But the opinion below stands alone in holding that he is entitled to do so as of right. Protection of one's assets from seizure or trespass by another has never depended on what use or profit he can make of

them. The contrary rule reflects itself in a host of instances in every field of law, of which a few are listed in the margin.[13]

A recent example is *Reading v. The Attorney General*, 1951 Appeal Cases 507, affirming *Reading v. The King* [1949] 2 K.B. 232, reviewed in Harvard Law Review for January 1952 at 502. There the Crown was held entitled to bribes received by a soldier through use of his uniform, although the Crown itself could never have used the uniform to earn bribes.

65 Harvard Law Review at 1257 comments:

> "[petitioner's] stock loss was an asset having value * * * even though [respondent] was the sole market and [petitioner] could utilize the stock loss in no other way."

The tax credit was petitioner's sole asset. The majority opinion has given to that fact the very reverse of its true significance. As Judge Fee pointed out (R. 2242):

> "* * * It seems to be assumed that the officers of plaintiff could give away the property right to file or refuse to file consolidated returns either voluntarily or acting under the control of defendant or the reorganization trustees. This is strange doctrine. * * * a transfer of all the assets of a corporation * * * cannot be made even by a majority of the stock. Neither officers nor directors, without a vote of the majority, have such power. In this case it is of stellar importance that this right of plaintiff was its sole asset and that, upon appropriation thereof, it became insolvent."

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[13] In the common law action of trespass *quare clausum fregit;* in suits for use of land where no injury has resulted and the owner could not itself have made use thereof, *United States v. Bernard*, 202 Fed. 728 (9 Cir.); in the field of eminent domain, cf. *Boom Co. v. Patterson*, 98 U.S. 403, 408, "property is not to be * * * regarded as valueless because he [the owner] is unable to put it to any use. Others may be able to use it * * *"; of patents, *James v. Campbell*, 104 U.S. 356, 358; *Bigelow v. RKO Pictures*, 327 U.S. 251, 265; of literary property, *Universal Pictures Co. v. Harold Lloyd Corporation*, 162 F.2d 354 at 368-370 (9 Cir.); *Stanley v. Columbia Broadcasting System*, 35 Cal.2d 653, 666, 667, 221 P.2d 73; in the field of unjust enrichment where recovery is measured by benefit received and not detriment sustained, *Edwards v. Lee's Administrators*, 96 S.W.2d 1028, 265 Ky. 418 (the famous *Kentucky Cave* case); *Restatement of Restitution*, Section 1, pp. 13, 15, Section 136, p. 553; in the fields of agency, 3 *C.J.S.* Agency Sec. 165; and trusts, 3 *Scott on Trusts*, Sec. 502, p. 2422; and in any other kind of fiduciary relationship, *Fleishhacker v. Blum*, 109 F.2d 543 (9 Cir.).

As 65 Harvard Law Review 1257 says:

> "[Respondent's] enrichment may have been unjust if, having caused [petitioner] to file the consolidated returns, it deprived petitioner of the opportunity to bargain for the value of its corporate assets: the right to use its stock loss for tax purposes."

CONFLICT WITH THE FIFTH CIRCUIT.

On the subject matter of this action, the appropriation of tax credits or rights belonging to one who could not use them by another who could, the decision below is in conflict with the *Shreveport Bank* cases, a series of decisions of the Fifth Circuit. *Connolly v. Commercial National Bank in Shreveport,* 189 F.2d 608, *Commercial National Bank in Shreveport v. Connolly,* 176 F.2d 1004, *Commercial National Bank in Shreveport v. Parsons,* 144 F.2d 231, cer. den. 323 U.S. 796, affirming *Leslie v. Commercial National Bank in Shreveport,* 28 F. Supp. 927.

There an insolvent bank transferred its assets to a new bank in pledge to pay its liabilities. The State imposed a tax on the capital stock of banks, assessable against the bank. In determining assessable value, the value of real estate owned by the bank was deductible from what would otherwise be the value of the stock. Reporting the real estate transferred to it by the old bank as its own, the new bank paid less taxes than it otherwise would. It was ordered to account to the old bank for the tax savings.

These cases not only hold, as 65 Harvard Law Review 1257 says, that "a tax saving may constitute enrichment," but they also make clear that the fact that one has a tax credit or advantage which he cannot himself use does not give another the right, free, to use it to his advantage. "The fact that the Old Bank suffered no loss * * * makes no difference." *Leslie v. Comm. Natl. Bank in Shreveport,* 28 F. Supp. 927, 933.[14]

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[14]The majority opinion dismisses the *Shreveport Bank* cases on the ground that the "new bank" was a "trustee." But there was no trust in the strict sense. There was a situation in which the officers were in dual relationship with respect to the two banks. *Leslie v. Commercial National Bank in Shreveport,* 28 F. Supp. 927, 933. The words "trust" and "trustees" are

The decision below is in conflict, also, with *Bankers Trust Co. v. Florida East Coast Car Ferry Co.*, 92 F.2d 450 (5 Cir.). That case recognized the duty of an affiliate to account for tax benefits obtained from consolidated reporting, to the party whose tax credits conferred the benefit.

CONFLICT WITH THE SECOND AND FOURTH CIRCUITS.

To justify its conclusion, the majority opinion below states that if the loss were respondent's and the income petitioner's petitioner could have compelled respondent to confer upon it the benefit of the loss by joining in consolidated returns.

This is in direct conflict with the Second and Fourth Circuits and the Board of Tax Appeals which held that a corporation, including one in bankruptcy, is free to join or not to join in consolidated returns as it sees fit.

In *George A. Fuller Co. v. Commissioner*, 92 F.2d 72 (2 Cir.) and *Trinity Building Corporation of New York*, 40 B.T.A. 1315, the Commissioner was upheld in refusing to accept consolidated returns filed by a parent and subsidiaries, because the trustees of a bankrupt subsidiary had refused to join. *Duke Power Co. v. Commissioner*, 44 F.2d 543 (4 Cir.), cer. den. 282 U.S. 903, reached the same conclusion as to such returns filed by two subsidiaries where the parent refused to join. The taxpayers were thus unable even to utilize the losses of those who did join.

PETITIONER WAS NOT A FIDUCIARY FOR RESPONDENT. THE REVERSE WAS TRUE.

To extend its rule of mandatory filing of consolidated returns to a situation where the parent-subsidiary relationship has been

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used in the *Shreveport* opinions because the courts were applying the "grand rule," the principle "that wherever a person clothed with a fiduciary character gains some personal advantage by availing himself of his situation as a trustee he becomes trustee of the advantage so gained * * *," and recognized that the rule "includes persons who are not trustees properly so called, but all those who stand in what is called a fiduciary position." Pound and Plucknett's *Readings on the History and System of Common Law* (3rd ed. 1927), p. 629; 4 *Pomeroy's Equity Juris.* (5th ed.), p. 263. On this principle respondent should account to petitioner.

severed, the opinion stated that a tax return is an historical document, that a fiduciary's duties with respect to matters arising during the fiduciary relationship continue through the period of winding up, and that the fiduciary who performs an act of winding up may not exact payment (R. 2234-5).

But petitioner was not respondent's liquidating agent nor its fiduciary. What makes one a fiduciary for another are the elements of dominance and the exercise of control and management. *Southern Pacific Company v. Bogert,* 250 U.S. 483 at 492; *North American Co. v. S.E.C.,* 327 U.S. 686 at 693; 65 Harvard Law Review, 1257. As said in 65 Harvard Law Review, 1257, "It may be strongly argued, then, that in the unique situation where the usual relationship is reversed, the subsidiary controlling the parent, the fiduciary duty is also reversed."

The majority opinion itself notes that after 1935 respondent "was no longer controlled by Corporation but by the trustees appointed by the bankruptcy court" (R. 2223) and that after adoption of the Plan of Reorganization "affiliation no longer existed" (R. 2231). The Plan cut off all possibility of a return of control, management, or financial interest. The loss arose from the Plan. The prior association could not impose the duty on petitioner to make a free grant to respondent of the only asset which the reorganization left petitioner, i.e., the tax utility of its loss.

On the contrary, by controlling petitioner's president so as to file the tax returns, respondent assumed a "determining position over the rights" of petitioner and thereby "owed an obligation to it". *Young v. The Higbee Co.,* 324 U.S. 204, 209, 210.

II.

If an Issue of Fact Not Found on by a Trial Court Is Thought Material, the Cause Should Be Remanded for Findings Thereon. The Court Below Exceeded Its Appellate Office by Making Findings ab Initio to Affirm the Judgment Upon a Legal Theory Different from That on Which the Trial Court Acted, and These Findings Were Contrary to What the Trial Court Made Clear It Would Have Found, Had It Considered the Issues Material, as Well as Contrary to Some Actually Made.

The majority opinion holds that petitioner may not recover although respondent appropriated its rights by dominating and controlling it. Concurrently, the majority reaches its decision by factually assuming that petitioner, not respondent, filed the tax returns, and that respondent did not dominate and use petitioner's officers. But, as said in 65 Harvard Law Review, at 1258, the moment "the issue of control [is] determinative of whether there could be recovery * * *, it would seem necessary for the court to have remanded to the district court for findings on that issue."

This is not a case where an appellate court has reversed a judgment because it believes the findings to be "clearly erroneous." What occurred here is, so far as we can find, unprecedented. Here an appellate court, sweeping aside a trial court's legal theories as unsound, has affirmed on a theory presupposing a set of facts upon which the trial court has not found and contrary to what that court has shown it would have found had it deemed them material, after hearing the witnesses and presiding over a living trial.

Nor is this a case where an appellate court, in affirming a judgment on a legal theory different from that of the lower tribunal, does so on the basis of facts found below which support the new theory. Here the legal theory is new and rests on facts found ab initio by the appellate court.

The majority opinion says (R. 2235):

> "The record is barren of evidence to support the contention that Corporation was dominated by the subsidiary,

> or that there was a breach of any duty owed to Corporation. As the trial court stated, 'The so-called "duality of control" much discussed and emphasized, is not important.' "

A casual reading of this extraordinary statement would suggest that the trial court had found absence of domination. But what the trial court said was this (R. 272):

> "Whether there was, or was not, 'duality of control' respecting the directorates of the two companies, appears to me to be not too important. *True, there is a preponderance of the evidence in favor of the plaintiff's contention of 'duality of control.'* "

And by "duality of control" it said that it meant

> "that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant." (R. 264)

The trial court declined to find any facts not material to the two legal theories on which it based its decision. It concluded that "there is little factual dispute pertinent to the issue decided," i.e., pertinent to *its* legal theories (R. 276), and that "The so-called 'duality of control,' much discussed and emphasized, is not important in resolving the tendered issue", i.e., the issue deemed by it to be important (R. 274).

Contrary to an assertion in the majority opinion below, the trial court gave permission to counsel to submit findings only if *"they are limited to the issues involving the essential equitable considerations upon which the decision rests"* (R. 276).

Thus, after hearing all the witnesses and performing the function which the law assigns to a trial court, the District Court made clear that, had it believed the issue material, it would have found in accordance with petitioner's claim, i.e., that respondent controlled petitioner and by means of that control caused it to file the consolidated returns for respondent's benefit. The importance which this Court attaches to a trial court's ability to see

the witnesses face to face is shown by *United States v. Oregon Medical Society*, 343 U.S. 326, 339 (Apr. 28, 1952).

But the Court of Appeals held that the trial court erred, both in what it considered the "essential equitable considerations" and in its two legal theories, and therefore that its findings did not support its judgment.

In consequence the parties have never had an opportunity to submit, argue and settle findings on the issues on which the Court of Appeals based its decision.

Judge Fee's dissenting opinion clearly states the situation (R. 2241):

> "Thus the two grounds advanced [by the Trial Court] to sustain the judgment fail. The cause should be reversed for failure to state adequate findings to support the judgment. Findings must be made in the Trial Court. Appellate courts have no such right or function. The majority opinion attempts to accomplish justification of the result below by drawing inferences, deductions and conclusions from evidence which they claim to find in the record. It would be possible for other judges to set up a diametrically opposite set of facts from which a judgment in favor of plaintiff might be based. The very reason that Rule 52 requires findings of fact is illustrated by the majority opinion. For the technical difficulties of finding a basis of fact for this judgment are many. Indeed, such difficulties are insurmountable."

Earlier Judge Fee had said (R. 2239):

> "There are no findings of fact [by the Trial Court] which support the judgment of the Trial Court or the affirmance thereof by a majority of this Court. The cause should be remanded for this reason alone."

THE TRIAL COURT REFUSED ADDITIONAL FINDINGS BECAUSE IT DEEMED THEM IMMATERIAL IN ITS VIEW OF THE LAW, WHICH THE COURT OF APPEALS REPUDIATED.

Contrary to the majority's assertion, petitioner submitted to the trial court proposed findings going to an essential basis on which the majority decided the case (R. 277-279). Their purport was

to state that respondent and not petitioner had acted in the premises. Because of the limitation placed by the trial court on proposed findings that it would receive, petitioner was precluded from asking for findings on "duality" and "domination" as such. But the same facts bore on whether petitioner took part in the tax transactions so as to be party to the wrongdoing which the trial court believed had been worked on the government. Findings on these issues were requested (Cf. R. 462, 463).

On settlement of the findings the trial court said that it agreed with petitioner's proposed finding to the effect that respondent *and not petitioner* had conducted the tax proceedings and that respondent had achieved this through control of petitioner. "There is no question about that," the court said (R. 468).

Petitioner urged, with prescience, that the facts should be stated clearly in "a set of findings so that the whole subject can be properly appraised above" (R. 463). The trial court thought that everything mentioned by petitioner could be gleaned from its "opinion some place or another" (R. 476 and see R. 470), but indicated it would make a specific finding as requested.

In the end it failed to do so and adopted its opinion as its findings. Notwithstanding the clear position of the trial court on these issues, the Court of Appeals made a contrary finding.

WHERE A TRIAL COURT FAILS TO FIND ON ESSENTIAL ISSUES, THE CAUSE MUST BE REMANDED.

R.C.P. Rule 52(a) provides that the trial judge "shall find the facts." That rule "was advisedly made mandatory * * *." 5 *Moore's Fed. Prac.* (2d ed.), p. 2657, fn. 21.

Where a finding has been made in the trial court, a Court of Appeals may set it aside where it is "clearly erroneous" and may reverse the judgment in consequence. But when a Court of Appeals does not have the benefit of an initial finding on a material fact by the trial court, it may not itself supply it.

"It is not the function of [an appellate court] to search the record and analyze the evidence in order to supply findings which the trial court failed to make." *Kelley v. Everglades Dist.*, 319

U.S. 415, 421; *Securities & Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 88. A reversal should follow failure to find at all on an issue held to be material. *Interstate Circuit Inc. v. United States*, 304 U.S. 55.

The Courts of Appeals have repeatedly so stated the law.[15]

There is an essential difference in the function of an appellate court and a trial court. As stated in oft-cited *Saginaw Broadcasting Co. v. Federal Communications Commission*, 96 F.2d 554, 559 (D.C. Cir.), an appellate court's function is to compare (1) rulings with the law and (2) findings with the record, not to extract findings from the record itself. When it has no specific finding before it, it has nothing to compare against the record and should reverse. So also *Commissioner v. Kolb*, 100 F.2d 920 (9 Cir.).

The vice of exploring the record to find facts *ab initio* is not only that it involves the appellate court in a new kind of task, but that it deprives the litigant of an opportunity to be heard. No proper machinery exists in an appellate court to settle findings in the first instance.

THE MAJORITY OPINION SETS UP A NOVEL AND FALSE PRINCIPLE CONCERNING THE POWER OF AN APPELLATE COURT.

The majority opinion disposes of the lack of findings to support its theory by saying that "Findings are not a jurisdictional re-

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[15]E.g., *Waialua Agricultural Co. v. Maneja*, 178 F.2d 603, 607, 608 (9 Cir.): "It is not the function of an appellate court to make findings on its own account." "The absence of findings * * * leaves no pediment on which a judgment can stand"; *Jacuzzi Bros. Inc. v. Berkeley Pump Co.*, 191 F.2d 632, 638 (9 Cir.): "The law does not commit that function to us, but solely the power to reverse if his findings be clearly erroneous"; *Helbush v. Finkle*, 170 F.2d 41, 42 (9 Cir.): Where a determination "would necessitate findings on questions on which the District Court has made no findings * * * such findings should be made by the District Court, not by this Court"; *Paramount Pest Control Service v. Brewer*, 170 F.2d 553, 554 (9 Cir.): "This Court of Appeals has no power *ab initio* to consider" issues on which no findings were made.

So also *Jones v. Waterman SS Corporation*, 155 F.2d 992, 997 (3 Cir.); *Kistler v. Gingels*, 171 F.2d 912 (8 Cir.); *Campbell v. Campbell*, 170 F. 2d 809 (D.C. Cir.); *McClure v. O. Henry Tent & Awning Co.*, 184 F.2d 636, 639 (7 Cir.).

quirement of appeal," and that an appellate court "may waive the defect on the ground that the error is not substantial in the particular case," if it feels able to find the facts itself (R. 2236). It supports this assertion by citing three cases, *Mayo v. Lakeland Highlands Canning Co.*, 309 U.S. 310, *Goodacre v. Panagopoulos*, 110 F.2d 716 (D.C. Cir.), and *Hurwitz v. Hurwitz*, 136 F.2d 796 (D.C. Cir.).

This Court nowhere stated in the *Mayo* case that when a case comes up without findings on issues which the appellate court deems material, it may make them *ab initio*. Its opinion contained a statement that findings are intended to benefit appellate courts. That statement is converted by the court below into a declaration that if the appellate court decides to find the facts itself it may dispense with findings by the trial court.

In *Goodacre v. Panagopoulos* and *Hurwitz v. Hurwitz*, there was no lack of supporting findings, but merely informality or irregularity in the mode of expressing them.

SUPPOSED PAST PRACTICE IN FILING CONSOLIDATED RETURNS FURNISHES NO BASIS FOR THE CONCLUSION THAT PETITIONER MUST FILE SUCH RETURNS AFTER IT HAD LOST ALL FINANCIAL INTEREST IN RESPONDENT.

In good part the majority opinion's factual conclusion that the use of petitioner's loss for respondent's benefit was petitioner's undominated act is based upon the practice in earlier years of filing consolidated returns.

But the relationship of petitioner and respondent was completely changed by this Court's approval in 1943 of the I.C.C.'s Plan of Reorganization. Prior to that time petitioner was respondent's owner. Thereafter they were total strangers to each other. A practice once followed between husband and wife is not pertinent to what should be done between divorced spouses. As Judge Fee pointed out, dissenting (R. 2248):

> "It is said, although there are no findings, that the history of prior consolidated returns is controlling. Of course, it cannot probably be shown how plaintiff heretofore dealt

with a consolidated return after there has been a divorce from a subsidiary."[16]

Furthermore, the loss here resulted from worthlessness of petitioner's stock in respondent. Since the tax law did not permit such a loss to offset operating income until October 1942, there was no prior practice on the use of such a loss.

Petitioner's loss with its utility for tax saving was its sole asset. There was no past practice about giving away a sole asset.

Moreover, if past practice were relevant petitioner would be entitled to a finding thereon by the trial court.[17]

III.

It Was Error to Deny Petitioner the Right to Petition for a Rehearing en Banc

[En banc discussion omitted]

CONCLUSION

We respectfully submit that this petition for certiorari should be granted.

Dated: San Francisco, California.
June 19, 1952.

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[16]The trial court itself had said (R. 1377):
"I just don't see the point of what any affiliated company has done in the past as a matter of practice in these returns, because they have all been decisions that have been made by the parent company, and when the parent company decided that it was proper to file affiliated returns, it filed them, * * *. What we have in this case is not concerned with that."

[17]For the 11 years prior to the first tax year here involved, there was not a single year in which respondent had any income (R. 1263), and in the last 5 years of that period neither respondent nor petitioner had any income. The losses of neither were used to offset income of the other (R. 2040, 2041). In still earlier years a subsidiary group joining with petitioner in consolidated returns did account to petitioner for the resulting tax savings (D. Ex. 40).